82-1121
NO. ________

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

LOUISIANA PUBLIC SERVICE COMMISSION,
Petitioner

versus

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

May "automatic adjustment clauses," permitting the continuous escalation of an interstate electric tariff without any requirement of a regulatory filing, be approved by the FERC to govern the interchange of power among affiliated operating companies, where the tariff directly affects intrastate rates and may cause these rates to be excessive, no special grounds exist to support the use of the automatic adjustment clauses, and the preemption doctrine probably renders the state regulatory commissions powerless to examine or adjust these expenses in setting intrastate rates?

PARTIES TO THE PROCEEDING

The following parties were involved in this case in the proceedings before the Federal Energy Regulatory Commission or the United States Court of Appeals for the Fifth Circuit:

1. Middle South Services, Inc., a subsidiary of Middle South Utilities, Inc., as the applicant before the Federal Energy Regulatory Commission and an intervenor before the United States Court of Appeals for the Fifth Circuit.

2. The Louisiana Public Service Commission, as an intervenor before the Federal Energy Regulatory Commission and the petitioner before the United States Court of Appeals for the Fifth Circuit.

3. The Federal Energy Regulatory Commission, as the respondent before the United States Court of Appeals for the Fifth Circuit.

4. The Arkansas Public Service Commission, as an intervenor before the Federal Energy Regulatory Commission.

5. The attorney general of the State of Arkansas, as an intervenor before the Federal Energy Regulatory Commission.

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PETITION FOR A WRIT OF CERTIORARI

The Louisiana Public Service Commission, petitioner, hereby petitions the Court to issue a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered on October 4, 1982.

OPINION BELOW

The opinion of the court of appeals, which is reproduced in the Appendix, is reported as *Louisiana Public Service Commission v. Federal Energy Regulatory Commission*, 688 F.2d 357 (5th Cir. 1982). The opinion of the Federal

Energy Regulatory Commission is also reproduced in the Appendix and is reported as *Middle South Services, Inc.*, Opinion No. 124, Docket No. ER 79277, 16 FERC ¶61, 101 (1981).

JURISDICTIONAL GROUNDS

The decision of the United States Court of Appeals for the Fifth Circuit was entered October 4, 1982. No application for rehearing was filed. This Court has jurisdiction to review the decision of the court of appeals pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS

The following statutes, set forth in the Appendix commencing at p. A-34, are involved in this case:

16 U.S.C. §824d(d);
16 U.S.C. §824d(f).

STATEMENT OF THE CASE

1. ***Preliminary statement.***

This case presents an important issue of federal regulatory law that arises in a context involving significant potential disruption of federal-state regulatory relations. The Federal Energy Regulatory Commission ("FERC") determined in the proceeding below that the normal requirement under the Federal Power Act of notice and regulatory review of a proposed rate change in interstate power transactions could be abrogated, with the utilities permitted instead to use "automatic adjustment clauses" to change these rates

without regulatory review. No evidence, or any other showing of "good cause," was required of the utilities for the approval of this proposal, though the FERC did note that the case fell into a category in which this approach has been approved in a few past proceedings.

This decision to embark on a program of regulatory abstention has large implications for the states. The tariff at issue involves interstate transactions among affiliated corporations in which the rate charges are set by the FERC, but the costs are accounted for in intrastate retail rate cases. A state regulatory body, such as the Louisiana Public Service Commission ("Louisiana Commission"), must assess the charges incurred by an operating company to intrastate ratepayers. However, under the preemption doctrine, the state agencies may not reduce or otherwise adjust the charges, even if they are based on imprudent or abnormal costs, because the charges are assessed under a tariff bearing FERC approval. Thus, in this case, the state regulatory agencies are precluded from conducting a regulatory review under the preemption doctrine, though the FERC has chosen to largely abandon its own obligation to conduct a regulatory review of any changes in the rate.

The decision of the FERC involves an agreement for the interchange of electric power among the operating companies of the Middle South Utilities System ("MSU"). These companies include Louisiana Power & Light Co. ("LP&L"), New Orleans Public Service, Inc., Mississippi Power & Light Co. and Arkansas Power & Light Co. The order of the FERC, affirming in part and modifying in part a decision of an administrative law judge, was issued July 30, 1981.[1] The

1/ R. 2021-36, *Middle South Services, Inc.*, Opinion No. 124, 16 FERC ¶61,101 (1981); App. at A-2.

Louisiana Commission filed a petition for review of the order in the court of appeals pursuant to 16 U.S.C. §825*l* (b). The court of appeals affirmed the decision of the FERC.[2]

2. ***Operation of the MSU System Agreement.***

The MSU System Agreement is the contract under which the operating companies of the MSU System exchange power. This agreement operates as the tariff approved by the FERC. The agreement reflects the principle that all generation additions in the MSU System are planned to serve the needs of the entire system. Thus, an individual company may be assigned the responsibility to construct capability in excess of its own load and need for reserves in order to serve the needs of other companies in the System. However, the excess capability is reallocated to the "short" companies, or "equalized," pursuant to the terms of the agreement.[3]

The provisions for capability "equalization" in the agreement are designed to allow the MSU System to equalize the reserve margin ratios of all the participants. These provisions assign system capability to each operating company in proportion to the company's share of the system load.[4] A similar allocation is made of the system intertransmission investment.[5]

2/ *Louisiana Public Service Commission v. Federal Energy Regulatory Commission*, 688 F.2d 357 (5th Cir. 1982); App. at A-21.

3/ Item "B" by reference, R. 2081-2198, Serv. Sched. MSS-1.

4/ *Id.* at 7-8.

5/ *Id.* at 9.

Pursuant to the provisions for capability equalization, a portion of the plant of the "long" companies is reassigned to the "short" companies.[6] A "monthly billing charge" is assessed to each "short" company for each kilowatt of capability assigned to the company.[7] The monthly billing charge is determined by a formula reflecting the monthly fixed costs assertedly associated with the "participation unit," the generating unit which is being shared, plus an amount for operation, maintenance and overhead expenses.[8]

3. *Use of automatic adjustment clauses.*

As proposed to and approved by the FERC, nearly all the charges under the MSU System Agreement are computed using automatic adjustment clauses. Under the provisions for capability equalization, the rates are automatically adjusted for changes in investment and capital costs whenever a new generating unit becomes the participation unit or whenever there has been a change in the investment in an existing participation unit.[9] In addition, the rates are automatically adjusted for changes in the expense attributable to income taxes, other taxes, depreciation, insurance, operation and maintenance expense, and general and administrative overhead expense.[10] The only fixed charge in the approved

6/ *Id.*, Serv. Sched. MSS-1, Serv. Sched. MSS-2.

7/ *Id.*, Serv. Sched. MSS-1, ¶10.06.

8/ *Id.*, ¶10.05.

9/ *Id.*, Serv. Sched. MSS-1.

10/ *Id.*, Serv. Scheds. MSS-1, MSS-2; Item "A" by reference, R. 1113-1210, Serv. Scheds. MSS-1, MSS-2.

formula is the cost of equity, which is set at 14 per cent.[11] A similar formula approach permits the charge for transmission equalization to be automatically adjusted.[12]

Many of the automatic adjustment clauses employed in the MSU tariff were approved by the Federal Power Commission in 1973.[13] However, no objections to the clauses had been lodged, nor had hearings been held on the propriety of the formulae.[14] In its filing in this case, MSU proposed to add to the automatic adjustment clauses for operation and maintenance and general and administrative overhead expense.[15] The Louisiana Commission contested the use of any automatic adjustment clauses in the tariff and the administrative law judge ruled that an examination of the entire tariff was proper.[16] The administrative law judge ultimately approved the use of the automatic adjustment clauses, but conditioned their operation on certain filing and

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11/ Opinion No. 124, R. 2021-36, at 12; App. at A-2.

12/ Item "A" by reference, R. 1113-1210, Serv. Sched. MSS-2.

13/ Order Accepting for Filing and Suspending Proposed Interconnection Agreement, Providing for Limited Hearing, and Establishing Procedures, *Middle South Services, Inc.*, Docket No. E-8130 (F.P.C., June 29, 1973).

14/ *Id.* at 1-2.

15/ Item "A" by reference, R. 1113-1210, Serv. Scheds. MSS-1, MSS-2.

16/ R. 120-21. This ruling was consistent with prior decisions of the FERC. *See, e. g., Southern California Edison Co.*, Docket No. ER 79-150 (FERC, March 15, 1979), slip opinion at 5. ("It is the entire rate, not just the increase, which is the subject of investigation"). *See also, Central Maine Power Co.*, Docket No. ER 79-539 (FERC, Sept. 28, 1979).

reporting requirements.[17] The FERC overruled this holding and approved all of the automatic adjustment clauses without condition.[18]

The evidence before the FERC showed that the automatic adjustment clause approach resulted in the assessment of charges under the federal tariff that would have been disallowed in an ordinary rate case. For instance, prior to 1980, MSU included accumulated deferred taxes in the rate base in computing the charges under the tariff in contravention of the rules of the FERC and policy stated in at least two FERC orders.[19] Similarly, nonrecurring expenses were included in the expenses used to develop the charge in the tariff for operation and maintenance and overhead expense.[20] These actions resulted in overcharges of millions of dollars.[21]

4. *Impact of the federal tariff on intrastate ratepayers.*

Although the payments under the MSU System Agreement are established under a federally-approved tariff, they are assessed and accounted for wholly in retail or wholesale rate cases.[22] For the purpose of fixing rates, rate base, revenues and expenses were not assigned to the federal

17/ *See* Initial Decision, R. 1763-1817, at 18-19.

18/ Opinion No. 124, R. 2021-36, at 5; App. at A-2.

19/ *See* Opinion No. 124, R. 2021-36, at 13; App. at A-2.

20/ R. 292 *et seq.*

21/ *Id.*

22/ Exh. 22, Prefiled testimony of Bruce M. Louiselle, R. 1031-45, at 4-6.

jurisdiction, as would occur in a normal federal ratemaking case. Instead, the tariff operates as a mechanism for shifting costs from one state to another. To the extent that an operating company is "long," revenues would be received by the company and shown in an intrastate rate case as a revenue credit. These receipts would reduce the revenues required to be provided in the intrastate jurisdiction by the consumer.[23] For "short" companies, the cost of intrasystem transactions would be shown as expenses, increasing the intrastate revenue requirement.[24] The rates established by the state regulatory agency would have to be sufficient to cover this expense and all other prudently incurred costs. The impact of the federal tariff may be the biggest reason for a rate increase; in the most recent case in Louisiana involving LP&L, for instance, the charges under the MSU tariff accounted for more than $47 million of the intrastate rate increase of about $118 million.[25]

The effect of the tariff is to shift costs from one company to another in the MSU System. If the tariff is too high, reflecting abnormal costs, a higher than required rate of return, or other improper items, ratepayers of the "short" companies are forced to subsidize ratepayers of the "long" companies.[26] If the tariff is too low, ratepayers of the

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23/ *Id.* at 4-5.

24/ *Id.* A relatively small portion of the expenses or credits would be accounted for in federal wholesale cases.

25/ *Ex Parte Louisiana Power & Light Co.*, Docket No. U-14690 (La. Pub. Serv. Comm. 1981).

26/ Exh. 22, Prefiled testimony of Bruce M. Louiselle, R. 1031-45, at 4-6.

"short" companies are subsidized.[27]

The MSU System as a whole tends to gain if the tariff is too high because of the effect of regulatory lag. If a "long" company receives excess revenues under the tariff, it is not likely to lower its intrastate rates. Its earnings may be excessive until its costs increase and force it to seek rate relief. A "short" company, on the other hand, will seek rate relief from the state agency as soon as it determines that the costs under the federal tariff will increase. In the most recent intrastate rate case of LP&L, the company *forecasted* the amount of expenses that would be incurred pursuant to the federal tariff in the test year.[28]

5. ***Decision of the FERC and the court of appeals.***

The FERC approved the formulae already embodied in the MSU tariff and also approved the new automatic adjustment clauses proposed by MSU.[29] This action allows MSU to continuously raise the rate for changes in all expenses except the cost of equity, without the requirement of any regulatory filing or review. No evidence was cited by the FERC as supporting its decision. Indeed, no evidence was submitted by MSU showing any special need for the use of the automatic adjustment clauses.

27/ *Id.*

28/ *Ex Parte Louisiana Power & Light Co.*, Docket No. U-14690 (La. Pub. Serv. Comm. 1980).

29/ *Middle South Services, Inc.*, Opinion No. 124, 16 FERC ¶61,101 (1981); App. at A-2.

The FERC made three observations as the basis for the approval of the automatic adjustment clauses. They are: 1) the tariff involves affiliates; 2) the tariff permits upward or downward adjustments of the rate as costs go up or down; 3) the costs included in the rate could be verified by an FERC audit or investigation.[30] No reasons were cited as establishing a need to depart from the normal regulatory process. The court of appeals affirmed on the basis of the observations of the FERC, without further analysis of the record.[31]

REASONS FOR GRANTING THE WRIT

This case presents an important regulatory issue, arising in the special context of federal preemption of state regulatory alternatives, that should be reviewed by this Court. The Federal Power Act and the leading authorities establish the federal regulatory policy that rate changes should be made only after a formal regulatory filing and review. Though automatic adjustment clauses may be approved in special cases, as when adjustments for fuel cost changes are made under clauses filed pursuant to detailed FERC regulations, they should not be approved in general rate cases on the bare basis of verbiage that does no more than describe the tariff. The approval of these clauses amounts to a regulatory abdication because regulatory agencies in general, and especially the FERC, are unlikely to take the initiative to investigate rate changes that occur without notification to the agency.

30/ **Opinion No. 124, R. 2021-36, at 5; App. at A-2.**

31/ ***Louisiana Public Service Commission v. Federal Energy Regulatory Commission*, 688 F.2d 357, 361 (5th Cir. 1982); App. at A-21.**

The delegation of ratemaking responsibility to the utility under automatic adjustment clauses is particularly inappropriate in this case, where the impact of rate changes is felt by intrastate ratepayers. The state regulatory commissions are prevented from disallowing or otherwise adjusting the charges assessed under the tariff because of the preemption doctrine, yet these agencies are not protected by the normal requirement of a federal ratemaking review. The federal-state tensions at play in this case provide additional content to the "good cause" requirement of the Federal Power Act, establishing that only very strong reasons should be sufficient for a waiver of the regulatory process. No sufficient basis for this action has been cited, or exists, in this case.

I. THE COURT SHOULD ISSUE THE WRIT TO DETERMINE WHETHER THE APPROVAL OF AUTOMATIC ADJUSTMENT CLAUSES IS CONSISTENT WITH FEDERAL REGULATORY LAW IN THE ABSENCE OF EVIDENCE SHOWING THAT THE NORMAL REGULATORY PROCESS IS UNWORKABLE OR ANY OTHER SPECIAL REASON TO SUPPORT THE WAIVER OF NORMAL REGULATORY REQUIREMENTS.

The Federal Power Act and the leading authorities establish that rate changes must be preceded by a regulatory filing with the FERC. This requirement may be waived by the FERC only for "good cause shown" and only when an order is issued specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.[32] This limited exception is

32/ 16 U.S.C. §824d(d).

not a general authorization for the FERC to permit the utility to change its rates, without any notice or other regulatory review, every time its costs change under an automatic formula. Moreover, the "good cause" requirement should not be satisfied by mere air-filled verbiage. Some showing of necessity to abandon the regulatory process should be required.

Under the ordinary rule in regulatory matters, the utility bears the burden of going forward and obtaining approval of a proposed rate change. This requirement includes the submission of the proposed tariff for the approval of the regulatory agency. The utility may be required to carry the burden of proving that its investment was prudently incurred and its expenses are fair and reasonable. Under principles announced by this Court in *Federal Power Commission v. Hope Natural Gas Co.*,[33] the regulatory agency has the responsibility to balance the interests of investors and consumers. The process ordinarily entails a full examination of the data submitted by the utility prior to the approval of a rate change.[34]

In contrast, the tariff approved by the FERC in this case amounts to an abandonment of the regulatory process. The rate may be changed as the result of changes in any item of cost except the rate of return on equity. These rate changes may be drastic because the tariff is based on

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33/ 320 U.S. 591, 64 S.Ct. 281 (1944).

34/ 1 A. Priest, *Principles of Public Utility Regulation* (1969) at 45-138; *South Central Bell Telephone Co. v. Louisiana Public Service Commission*, 352 So.2d 964, 968 (La. 1977).

the costs associated with the "participation" unit, or unit that is being "equalized," and this unit is the most recent generation constructed by the "long" company. Thus, when a new unit goes on line, it becomes the participation unit, and virtually all the costs on which the rate is based are changed. The utility may recompute the rate on its own, including all costs in the tariff whether or not they are normal and prudently incurred, without the requirement of any regulatory review.

This approach reflects a substantial change in regulatory attitude, because it entrusts the responsibility for protecting the public interest to the utility. As MSU conceded in its brief filed with the court of appeals, the FERC is no longer "the front-line of regulatory protection against either imprudent management decisions or irregular cost recordation."[35] Instead, MSU suggested, the public can depend on the auditors employed by MSU for protection.[36] In oral argument before the court of appeals, counsel for the FERC stated that the FERC assumes the utility will act properly, or that improprieties might be uncovered in the general, periodic audits conducted by the FERC.

This approach is inconsistent with the Federal Power Act, which establishes the general rule that no rate change may go into effect without first being submitted to the regulatory process. Section 205(d) of the Act, as amended,

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35/ Brief for Intervenor Middle South Services, Inc. at 25, *Louisiana Public Service Commission v. Federal Energy Regulatory Commission*, 688 F.2d 357 (5th Cir. 1982).

36/ *Id.*

states:

> Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rate, regulation, or contract relating thereto, except after sixty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the sixty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.[37]

The policy embodied in this law recognizes that governmental agencies have limited resources and by nature tend to react rather than act. These agencies do not frequently initiate inquiries to uncover improprieties in the absence of an outside prod. However, by placing the burden on the utility to institute the regulatory process as a prerequisite to a rate change, the law ensures a degree of protection to the public.

The policy requiring a regulatory filing prior to a rate change has been endorsed by this Court. Indeed, the Court

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37/ 16 U.S.C. §824d(d).

has indicated that an agreement, even if filed as a rate schedule, may not provide for increased rates without a regulatory filing. *Sunray Mid-Continent Oil Co. v. Federal Power Commission.*[38] In *Sunray*, the Court interpreted provisions of the Natural Gas Act virtually identical to the provisions of the Federal Power Act that control this case.[39] The Court held that the FPC was not bound by the limitations of a contract in the determination of the service obligation of a utility, even if the contract has been approved. It referred to automatic adjustment clauses in illustrating the point. It said:

> For example, an independent producer may file as its rate schedule its contract of sale with a pipeline company. That contract may provide in explicit terms for an adjustment of rates at a future time - - even one foreordained in a precise amount. Yet when the adjustment is made pursuant to the contract, the adjustment is subject, as a "change" in rates, to the procedures of §§4(d) and 4(e) - - however explicit the upward adjustment was in the contract from the start.[40] [Citations omitted].

Thus, the Court concluded that federal law would not permit automatic adjustments unchecked by regulation.[41]

The policy against automatic adjustments was also applied

38/ 364 U.S. 137, 153, 80 S.Ct. 1392, 1402 (1963).

39/ 15 U.S.C. §717c(d).

40/ 364 U.S. at 152-53, 80 S.Ct. at 1401.

41/ *Id.* at 153, 80 S.Ct. at 1402.

in *Episcopal Theological Seminary v. Federal Power Commission,*[42] a case cited with approval by the Court in *Sunray.*[43] In *Episcopal Theological Seminary,* the court disapproved the use of an escalation clause in a gas case. Interpreting the sister provision to Section 205(d), it stated:

> Section 4(d) . . . requires that the public must be kept informed of the "changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect." No change may be made in a "rate" or "schedule then in force," without notice to the Commission and the public. This language is persuasive that forehanded contractual provisions cannot modify the regulatory provisions of the Act as urged by petitioners. The purpose is to advise the public of a change in the current rate.[44]

The court ruled that the "rate" is the cents per unit charge and a regulatory filing is a prerequisite to changing the rate.[45]

Although these authorities indicate that automatic adjustment clauses might never be acceptable, we recognize

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42/ 269 F.2d 228 (D.C. Cir. 1959).

43/ 364 U.S. at 153, 80 S.Ct. at 1401-02.

44/ 269 F.2d at 233.

45/ *Id.* at 235.

that they are sometimes used because of necessity. Thus, in the case of fuel costs, automatic adjustment clauses have been approved by the FERC because of fluctuations of these costs and the difficulty of determining them in advance. However, these formulae must comply with detailed regulations of the FERC adopted on a generic basis.[46] The regulations reflect a limited departure from the regulatory process adopted only after a finding of good cause.

In 1978, Congress apparently recognized that the FPC and FERC had permitted departures from the normal regulatory requirements by allowing certain automatic adjustment clauses to be included in utility rate schedules. Therefore, Congress amended the Federal Power Act and required the FERC to review these clauses to determine whether the clauses existed for costs that are not "subject to periodic fluctuations" and not "susceptible to precise determinations in rate cases prior to the time such costs are incurred."[47] The FERC was authorized to invalidate clauses that do "not result in economical purchases of fuel, electric energy, or other items. . . ."[48] These amendments give content to the "good cause" requirement of Section 205(d), establishing that departures from the normal regulatory process are justified only in the limited circumstances when this action is necessary because normal ratemaking is unworkable, and only when safeguards exist to promote efficiency and econ-

46/ *E. g.*, 18 C.F.R. 35.14.

47/ 16 U.S.C. §824d(f) (1) (B).

48/ 16 U.S.C. §824d(f) (3) (B).

omy in the cost incurrence of the utility.[49]

In this case, no generic regulation exists to permit the automatic adjustment clauses. No evidence was submitted by MSU as a special justification for the adoption of the clauses. No review was made of special reasons justifying the waiver of the regulatory process. In a single paragraph devoted to the "good cause" issue, the FERC noted that 1) the case involves affiliates; 2) the formulae permit upward or downward adjustments in the rate; and 3) the FERC can always institute an audit or investigation to uncover improprieties.[50] This explanation is nothing more than a description of the tariff coupled with an air-filled assurance that the regulatory abdication may not be total.

First, the "affiliate" point is nothing more than an obser-

49/ A 1975 House of Representatives report on automatic adjustment fuel clauses concluded that they should be abolished except in emergencies. In addition, it found that "[a]utomatic fuel adjustment clauses threaten the basis of utility regulation to the extent that their use encourages the adoption of similar automatic adjustment clauses encompassing other key aspects of utility regulation." Subcomm. on Oversight & Investigations of the House Comm. on Interstate and Foreign Commerce, 94th Cong., 1st Sess., Report on Electric Utility Automatic Fuel Adjustment Clauses (Subcomm. Print 1975) at 3,2. Other studies have suggested that the use of automatic adjustment clauses violates due process, reduces the incentive for cost control, and runs counter to traditional principles of utility regulation. *E. g.*, M. Schmidt, Automatic Adjustment Clauses: Theory and Application (MSU Pub. Util. St. 1980) at 123-24; Craft, *Due Process Restraints on the Use of Automatic Adjustment Clauses in Utility Rate Schedules*, 18 Ariz. L. Rev. 453 (1976); Note, *Due Process and the Automatic Fuel Adjustment Clause*, 52 Ind. L. J. 637 (1977).

50/ Opinion No. 124, R. 2021-36, at 5; App. at A-2.

vation of the corporate relationship of the transacting parties. It does not by itself embody any reason to abrogate regulation. As the FERC noted, automatic adjustment clauses have been permitted in a few past cases involving affiliates,[51] but these cases do not provide reasons for departing from the statutory requirements. Indeed, the FERC was able to cite only two isolated cases to the court of appeals in which these clauses were ultimately approved; neither case involved a dispute about the clause or an examination of the justification for its adoption.[52] Moreover, to the extent that these clauses have been approved in unreported proceedings involving affiliates, the only importance of the "affiliate" point is to provide the explanation that the issue was probably undisputed, and the case settled, because all parties were part of the same corporate family. When all parties to a tariff agree on its adoption, the FERC is prone to approve the tariff without a stringent review.

51/ *Id.*

52/ The cases were *American Electric Power Co.*, Opinion No. 50 (1979), 19 Fed. Pow. Serv. 5-869, *aff'd sub nom. Ohio Power Co., et al v. Federal Energy Regulatory Commission*, 668 F.2d 880 (6th Cir. 1982) and *Arizona Public Service Co.*, 54 FPC 1232, 54 FPC 1984 (1975). The FERC cited two other cases involving the use of these clauses. In one, the FERC found that these provisions are "unjust and unreasonable and in contravention of §205 of the statute. . . ." A court of appeals remanded the issue for further consideration, but ultimately the rejection of the clause was upheld. *South Carolina Generating Co. v. Federal Power Commission*, 249 F.2d 755, 765 (1957), 261 F.2d 915 (4th Cir. 1958). In the other, a court of appeals determined that no adequate showing was made to permit a departure from the normal regulatory process. *American Louisiana Pipe Line Co. v. Federal Power Commission*, 344 F.2d 525 (D.C. Cir. 1965).

The involvement of affiliates is a reason to disapprove, not approve, automatic adjustment clauses. If inequities arise in a formula tariff involving unrelated corporations, the injured party is likely to provoke a regulatory review. In the case of affiliates, on the other hand, a corporate decision may ordain that one company suffer a loss in order to gain an overall advantage for the corporate family. In this case, inequities suffered by ratepayers are not likely to be called to the attention of the FERC by an individual operating company.

Second, the potential for "upward and downward"[53] adjustments is no basis for abandonment of regulatory review. This observation is true of an automatic adjustment clause in any context. The Federal Power Act prohibits *any change* in rates without a regulatory filing.[54] In this case, inequity may be caused to the ratepayers of a "long" company from a downward change in the rate, just as it may be caused to the ratepayers of a "short" company from an upward change.

Third, the possibility of an audit or investigation is not a basis for abrogation of the normal regulatory process. The FERC always has the right of audit; it has not determined to take any special investigative steps with respect to the MSU System. Moreover, this possible safeguard has failed in the past to uncover improprieties in the tariff, including the practice of including deferred taxes in the rate base, which violated FERC regulations. Thus, it offers little solace to intrastate ratepayers.

53/ Opinion No. 124, R. 2021-36, at 5; App. at A-2.

54/ 16 U.S.C. §824d.

In contrast to the absence of evidence supporting the adoption of the automatic adjustment clauses, there is substantial evidence establishing that these clauses have resulted in unjust rates. For instance, the accumulated deferred taxes associated with various participation units were included in the rate base used to compute the tariff from 1973 to 1980 in violation of FERC regulation.[55] This practice would not have been permitted in Louisiana.[56] Moreover, the chief MSU witness conceded that abnormal costs were included in operation and maintenance and overhead expenses used to fix the rate. The total amount of the abnormal expense in 1977 and 1978 was nearly $25 million.[57] The inclusion of these costs is contrary to proper regulatory policy.[58]

The "good cause" requirement for waiver of the regulatory process requires more than a bare description of the transaction. In this case, no evidentiary or policy basis has been cited as justifying regulatory abdication. This Court should review the case to determine the circumstances under which the FERC may abandon its statutory duty.

55/ *See* Opinion No. 124, R. 2021-36, at 13; App. at A-2.

56/ *E. g., Ex Parte South Central Bell Telephone Co.*, 15 PUR 4th 87, 111 (La. Pub. Serv. Comm. 1976).

57/ R. 296.

58/ The FERC conceded in the court of appeals that a regulatory body should delete "these unrepresentative costs from the estimated costs of service upon which rates will be based." Brief for Respondent Federal Energy Regulatory Commission at 13, *Louisiana Public Service Commission v. Federal Energy Regulatory Commission*, 688 F.2d 357 (5th Cir. 1982).

II. THE WRIT SHOULD BE GRANTED TO DETERMINE WHETHER, IN THE CONTEXT OF PREEMPTION OF STATE RATEMAKING AUTHORITY, THE FERC MAY ABANDON THE NORMAL REGULATORY PROCESS.

Although the MSU tariff is subject to the interstate jurisdiction of the FERC, all the charges assessed under the tariff are collected from consumers in intrastate rate cases. The regulatory agencies in the state where the operating companies are "short," including the Louisiana Commission, must increase intrastate tariffs to include the charges paid by the "short" company to its affiliates. However, under the preemption doctrine, these agencies cannot reduce or otherwise adjust the charges to reflect proper ratemaking principles. Because the responsibility for ensuring fairness has been given the FERC, the state regulatory agencies must simply accept the charge.

We do not contend that Congress is unable under its Commerce Clause power to preempt the area of interstate electric regulation or that this action necessarily violates the tenets embodied in the Tenth Amendment. However, we do believe that the federal-state tensions arising from this preemption give added content to the policy of the Federal Power Act requiring adherence to the normal regulatory process. Congress could not have intended to preclude the states from taking any action to protect consumers while permitting the FERC to abandon its own right of review.

The application of the preemption doctrine in this context is reflected in a line of cases decided by the state courts. For instance, in *United Gas Corp. v. Mississippi Public*

Service Commission,[59] the Supreme Court of Mississippi held that the state regulatory commission could not disallow gas charges between affiliated corporations where the Natural Gas Act vested jurisdiction in the FPC to establish the rate. The court determined that the FPC could and would protect the public: "There is nothing to suggest that the FPC will not closely scrutinize the relationship, for the statutory purpose of protecting the public and consumers from exploitation."

Similarly, in *Narragansett Electric Co. v. Burke,*[61] the Supreme Court of Rhode Island held that the preemption doctrine precluded the state regulatory body from disallowing expenses incurred under a tariff subject to FPC jurisdiction. The court cited and relied on the Mississippi case, including the notation that the FPC presumably would discharge its duty to protect the public and consumers.[62] In another leading case, *City of Chicago v. Illinois Commerce Commission,*[63] the court determined that the state commission was "without power to consider the reasonableness of the FPC rates . . . ."[64] It relied in part on the observation that the FPC would "obey the Congressional mandate" to closely scrutinize the arrangement for the statutory

59/ 240 Miss. 405, 127 So.2d 404 (1961).

60/ 127 So.2d at 420.

61/ 381 A.2d 1358 (R. I. 1977).

62/ *Id.* at 1362-63.

63/ 13 Ill.2d 607, 150 N.E.2d 776 (1958).

64/ 150 N.E.2d at 781.

purpose of protecting the public interest.[65]

These cases indicate that a state regulatory body must approve and flow through any expenses incurred by a utility under a federal tariff. The federal imprimatur stamps the charges as *per se* reasonable for intrastate ratemaking purposes. Ironically, these cases also indicate that the charges could be assessed by the state agencies to consumers under automatic adjustment clauses in view of their presumptive fairness.[66]

Each of the preemption cases is premised on an assumption that the federal agency will conduct a proper regulatory review. Indeed, the conclusion that Congress intended to preempt state power is premised on the determination that Congress mandated the federal agency to perform its regulatory functions. These precedents establish that, in the context of preemption, only a very strong showing of necessity will justify abandonment of the regulatory process embodied in the Federal Power Act.

Other federalism concerns establish that regulatory abdication should generally be prohibited in this context. If the charges under an interstate tariff have not been reviewed by the FERC, but instead reflect the operation of automatic formulae, the state commissions may have good reason to test the limits of the preemption doctrine by disallowing or adjusting the expenses. In other cases, the federal charges may be allowed, but offsetting adjustments in intrastate expenses implemented to determine if the pre-

65/ *Id.* at 780.

66/ *E.g.*, *Id.*

emption doctrine precludes this approach. These actions, though reasonable in light of the regulatory waiver of the FERC, would strain the operation of the federal system.

In addition, the requirement of a proper regulatory review is mandated by considerations of full political accountability. The state commissions, which are answerable to consumers, could not abdicate the regulatory process by adopting automatic adjustment clauses for the pass-through of virtually all utility costs. Yet these agencies must assess charges at the state level that have not been subjected to a regulatory analysis. The state commissioners remain accountable for the rates, yet do not even have the assurance that the FERC has performed a regulatory analysis. This result further strains federal-state relations.[67]

The context of preemption gives a special responsibility to the FERC to perform its regulatory function. Therefore, the Court should grant a writ to determine whether a mere description of the tariff, without the citation of evidence or any supporting policy reasons, is sufficient cause to abandon the regulatory process in the preemption context.

CONCLUSION

This case presents an important question of federal regulation arising in a special context. The Court should issue a writ to determine the basis on which the FERC may abandon the normal regulatory process required under the Federal Power Act. Consideration of this case is especially important

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67/ *See Federal Energy Regulatory Commission v. Mississippi*, 102 S.Ct. 2126, 2152 (1982) (O'Connor, J., concurring in part and dissenting in part).

because the federal abdication is occurring in an area in which state ratemaking functions have been preempted. Therefore, a writ should be issued.

Respectfully submitted,

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